

**DEPARTMENT OF BUSINESS REGULATION
SECURITIES REGULATION PROGRAM
PERFORMANCE AUDIT
FISCAL YEAR ENDED JUNE 30, 2000**

**DEPARTMENT OF ADMINISTRATION
BUREAU OF AUDITS
ONE CAPITOL HILL
PROVIDENCE, RI 02908-5889**

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STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

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October 2, 2001

Ms. Marilyn Shannon McConaghy, Director
Department of Business Regulation
233 Richmond Street
Providence, RI 02903

Dear Ms. McConaghy:

We have completed our performance audit of the Department of Business Regulation, Securities Regulation Program. Our audit was conducted in accordance with Sections 35-7-3 and 35-7-4 of the Rhode Island General Laws.

The findings and recommendations included herein have been discussed with management and we have considered their comments in the preparation of our report. Management's responses to our audit recommendations have been included in our report.

In accordance with Section 35-7-4 (c) of the Rhode Island General Laws, we will review the status of the Department of Business Regulation's corrective action plan within 6 months from the date of issue of this report.

Sincerely,

Stephen M. Cooper, CFE, CGFM
Chief, Bureau of Audits

SMC(SME):pp

DEPARTMENT OF BUSINESS REGULATION
SECURITIES REGULATION PROGRAM
PERFORMANCE AUDIT
FISCAL YEAR ENDED JUNE 30, 2000

INTRODUCTION

Objectives, Scope, and Methodology

We conducted a performance audit of the Department of Business Regulation, Securities Regulation Program for the fiscal year ended June 30, 2000. Our objectives were to evaluate the adequacy and effectiveness of managerial controls, the economy and efficiency of operations, and compliance with significant laws and regulations applicable to the program. Our audit was made in accordance with the *Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors.

To accomplish our objectives, we reviewed the operations of the program to ascertain whether the results were consistent with the goals of the program and were carried out as planned. We also reviewed the reliability and integrity of financial and operating information. We interviewed responsible personnel, and performed tests of the accounting records and all auditing procedures, as we considered necessary in the circumstances.

The findings and recommendations included herein have been discussed with management and we considered their comments in the preparation of our report. Management's response to our audit findings and recommendations were submitted on September 26, 2001 and are included in our report.

Background

The Department of Business Regulation was established by the Rhode Island General Assembly in 1939 and is organized under Title 42 of the Rhode Island General Laws. The Department is composed of five divisions, one of which is Securities Regulation.

The Securities Division is responsible for the registration of certain securities, the licensing and regulation of broker dealers, sales representatives, certain investment advisers, and certain investment adviser representatives. This division has annually processed approximately 68,149 licenses and registrations, conducted on-site examinations of broker dealers and investment advisers, and initiated investigations and enforcement actions pursuant to applicable state and federal laws and regulations. Additional duties include enforcing compliance with the applicable provisions of state laws and regulations related to franchises, charities, fundraisers, and time-shares.

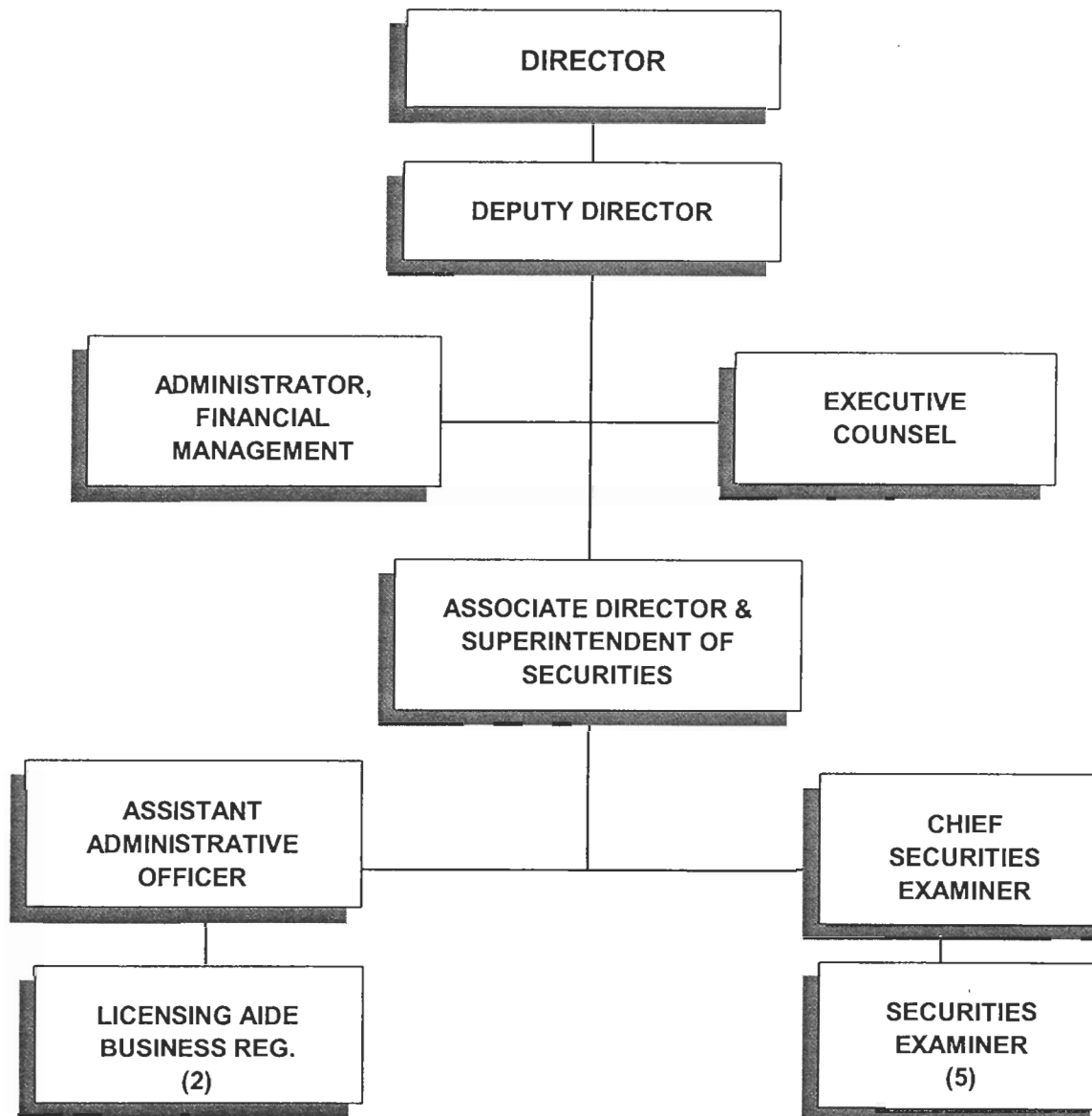
Number of Licenses/Registrations

Activities	FY 1998	FY 1999	FY 2000
Investments	57,453	55,526	60,584
Securities	4,758	5,029	5,970
Franchises	720	720	672
Charities	756	808	911
Time Sharing	13	10	12

COMPLAINTS 19 64 71

Source: Department Business Regulation

DEPARTMENT OF BUSINESS REGULATION
SECURITIES REGULATION PROGRAM
FISCAL YEAR ENDED JUNE 30, 2000
ORGANIZATIONAL CHART



DEPARTMENT OF BUSINESS REGULATION
SECURITIES REGULATION PROGRAM
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FINDINGS AND RECOMMENDATIONS

ECONOMY AND EFFICIENCY OF OPERATIONS

Division Staffing

It is the responsibility of the Securities Division to ensure that the general public has as much protection as possible against deceptive and/or fraudulent investment activities. As of 1999 the *Investment Company Institute* and the *Securities Industry Association* estimated that almost 78.7 million Americans owned stock directly or through mutual funds. Our review of the Securities Division disclosed that over the years the volume of investment as well as franchise, charitable organizations, fundraisers, and timeshare activity the Division is responsible for licensing, registering, and monitoring has increased. The Division increased their staff from 8 to 10 employees between 1998 and 2001 in an effort to meet the increased workload. Four of the ten employees currently working in the Securities Division are or will become eligible for retirement within the next 5 years. Two of those employees are securities examiners. It should be noted that the work of the securities examiners encompasses all of the activities within the unit. Given the nature and complexity of the work involved in the Division combined with a potential loss of two experienced examiners, management should take a proactive approach in planning for its future staffing needs. Although the Division has increased the number of Securities Examiners from 3 to 5 within the last two years, this level of staffing may not be sufficient to continue providing the current level of protection to the general public.

In addition to supervising and monitoring the various entities within the unit, the Securities Division is responsible for providing consumer relief through a formal complaint process. During fiscal year 2000, the Securities Division received 71 complaints (an increase of approximately 250% over fiscal year 1998) and 94 unresolved complaints are pending. Our review disclosed that the complaints are currently being processed timely and efficiently. However, as the activities within the various segments of the Division continue to grow, logic dictates that the Securities Division personnel will be responsible for addressing/resolving an increased number of complaints. Current staffing levels may no longer be sufficient to continue to provide the

public with the present quality of service. Additionally, increased staffing levels may afford the Securities Division to become more proactive in its method of handling consumer complaints.

Recommendation

1. Management's strategic planning for the future should provide for optimum staffing based on present and expected industry trends.

Management's Response

Accepted

Advancement Opportunities

Our analysis of the professional classifications within the division disclosed a lack of advancement for securities examiners. During a 3-month period the division sustained the loss of a securities examiner and the Chief Securities Examiner. These employees accepted promotional positions outside of the Securities Division. Given the size of the Division, this is a significant loss of experienced personnel. The learning curve for a securities examiner position is extensive. Management must invest a considerable amount of time training new employees each time these positions become vacant. Providing opportunities for advancement within this classification may help to increase personnel retention thereby enabling management to use its training resources more economically and efficiently.

Recommendation

2. To deter frequent staff turnover management should work with the Office of Personnel Administration in developing a model of hierarchy within the Securities Division.

Management's Response

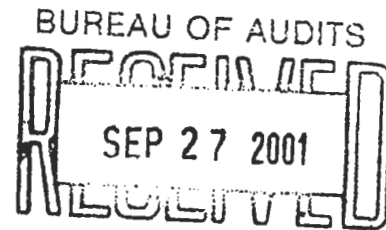
Accepted



STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

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September 26, 2001



Stephen M. Cooper, CFE, CGFM, Chief
Department of Administration
Bureau of Audits
One Capitol Hill
Providence, RI 02908-5889

Dear Mr. Cooper:

Pursuant to the recent performance audit of the Securities Division conducted by your agency and the September 21, 2001 memorandum from Shirley Egan, Internal Audit Manager, the following responses are hereby submitted:

Recommendation

1. Management's strategic planning for the future should provide for optimum staffing based on present and expected industry trends.

DBR Response: The Division accepts this recommendation.

In addition to the two (2) examiners referred to in the audit report, the Department is requesting an increase of two (2) entry-level Securities Examiners and a Licensing Aide. This request is a "special initiative" included in budget requests for fiscal year 2003.

Recommendation

2. To deter frequent staff turnover, management should work with the Office of Personnel Administration in developing a model of hierarchy within the Securities Division.

DBR Response: The Division accepts this recommendation.

Stephen M. Cooper, CFE, CGFM, Chief
September 26, 2001
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The Department is in the process of requesting a new classification entitled "Senior Securities Examiner" at grade level 28 (\$37,132 - \$41,923). This is four (4) grades higher than the grade 24 assigned to Securities Examiners (\$31,015 - \$35,758). The Department is also considering a Principal Securities Examiner classification at grade level 31 (\$41,6670 - \$47,170). If these recommendations are approved by the Department of Administration following a public hearing and approved by the Governor, the new classifications will parallel the examination hierarchy in the Banking Division and the Insurance Division.

Please contact me or Deputy Director Anthony V. Arico, Jr. if you have any questions or if additional information is needed.

Yours truly,



Marilyn Shannon McConaghy
Director

MSM:cass

cc: Dr. Robert L. Carl, Director, Department of Administration
Representative Gordon Fox, Chairman, House Finance Committee
Senator Frank T. Caprio, Chairman, Senate Finance Committee
Shirley Egan, Internal Audit Manager
Anthony V. Arico, Jr., Deputy Director
David Briden, Chief Securities Examiner
Bernard E. Lane, Jr., Department Budget Administrator